HOUSING PROGRAM

(ES-0087)

EXECUTIVE SUMMARY

Borrower: Republic of El Salvador

Executing agency: Ministry of Public Works, Transport, Housing, and Urban Development, through the Vice Ministry of Housing and Urban Development (VMVDU).

(in US$ millions)

		Phase one	Phase two	Total
Amount and source:	IDB	US$70,0	US$25,5	US$95,5
	OC:	US$37,6	US$25,5	US$63,1
	OC/IFF:	US$32,4		US$32,4
	Local:	US$24,1	US$23,1	US$47,2
	Total:	US$94,1	US$48,6	US$142,7

Financial terms and conditions:

Amortization period:	25 years
Grace period:	4 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1.00%
Credit fee:	0.75%
Currency:	U.S. dollar; under the Single Currency Facility

Objectives: The objective of this program is to support the Government of El Salvador in developing and introducing a set of sustainable housing policy instruments. These instruments will improve the housing sector's capacity to provide an efficient and equitable response to the demand for housing among the various income groups in the urban population.

Description:

A. Phase 1

Phase one of the program is divided into three subprograms: (i) the formal housing market; (ii) the informal housing market; and (iii) the Municipality of San Salvador.

Subprogram I: Formal market

1. Strengthening the mortgage market (US$500,000)

The objective of this component is to introduce new financial instruments and to develop a legal framework capable of channeling long-term resources to formal institutions that finance housing. This component will finance the Action Plan for development of the secondary mortgage market. Under this component studies will be conducted and consultants hired to draft viable and easily implementable proposals to improve primary and secondary mortgage market operations. This component will be carried out by the Multisector Investment Bank (BMI).

2. Institutional and financial strengthening of the Fondo Social para la Vivienda – FSV (US$3.8 million)

The FSV is a first-tier financial institution that serves the middle-income population with mortgage lending for home buying. The objective of this component is to ensure the medium-term sustainability of the FSV by introducing policy and management system reforms that will increase efficiency and improve the risk profile of its portfolio. A modernization plan has been designed and agreed upon with the FSV's senior management: (i) to strengthen its management procedures and systems; (ii) to reform its credit policy and administration; and (iii) to strengthen its management structure. This component will finance the cost of implementing the plan, and activities in support of these reforms. This component will be carried out by the FSV.

Subprogram II. Informal market

1. Subsidies for upgrading marginal neighborhoods (US$40 million)

The objective of this component is to introduce a system of direct subsidies to provide basic services to the low-income neighborhoods and to strengthen the municipal housing programs. This component will finance (a) collective subsidies for neighborhood upgrading projects; and (b) institutional strengthening activities in participating municipalities. The participating municipalities will carry out improvement projects, for which they will receive technical assistance. The maximum amount of the subsidy is US$2,000 per household, with 2,000 families benefiting from this component, which will be carried out by the Vice Ministry of Housing and Urban Development and the National Low-Income Housing Fund (FONAVIPO).

2. Reconstruction subsidies (US$20 million)

The objective of this component is to channel subsidies to a permanent housing solution for low-income families left homeless by the two most recent earthquakes. These resources will be used to build housing at existing sites and in new settlements. The maximum value of an individual subsidy is US$2500, with 8,000 families from this component, which will be carried out by the Vice Ministry of Housing and Urban Development and the National Low-Income Housing Fund (FONAVIPO).

3. Land legalization (US$4 million)

The objective of this component is to expand the scale and efficiency of land legalization programs, in order to reduce illegal land tenure in low-income urban neighborhoods. This component will finance the legalization and registration of 20,000 individual titles in illegal marginal settlements created prior to 1995, at an average estimated cost of US$200 per lot. This component will be carried out by Instituto Libertad y Progreso (ILP).

4. Progressive development of subdivision market (US$1 million)

The objective of this component is to implement a set of standards and procedures to improve the progressive development of a subdivision market in terms of performance. This component will finance three main activities: (i) introduction of a certification process for developers; (ii) dissemination of information on the sector; and (iii) proposed review of regulations applicable to progressive development of residential subdivisions. This component will be carried out by the Vice Ministry of Housing and Urban Development.

5. Modernization of the Vice Ministry of Housing and Urban Development (US$5.6 million)

The objective of this component is to improve the efficiency of the VMVDU in performing its duties of regulating and promoting the housing sector, and analyzing and disseminating information. This component will finance the cost of implementing the action plan for institutional modernization of the VMVDU and the administrative costs of the program. This component will be carried out by the Vice Ministry of Housing and Urban Development.

Subprogram III. Municipality of San Salvador program (US$11.1million)

The objective of this subprogram is to finance direct subsidies to improve the housing conditions of low-income groups in the Municipality of San Salvador. With some minor differences, this subprogram will follow the general outlines of the component providing subsidies for upgrading marginal neighborhoods (Subprogram II) 3,000 families will benefit from it, and will also finance technical assistance for the Municipality of San Salvador, which will carry out the components of this subprogram.

B. Phase 2

The program has been divided into two phases to accommodate the complex reforms that are needed to ensure the sustainability of the FSV. In phase one, the FSV modernization plan will be implementing, thus consolidating the processes and systems that are required to enhance financial management. In addition, a series of dissemination activities will be pursued to provide public information on the new subsidy policy.

In phase two, financing will be provided for direct subsidies to the FSV's target population. FSV management will replace the subsidized interest rate system with one based on direct subsidies - a system that is efficient, targeted, and sustainable. This policy will ensure that the Fund's target population has access to housing loans on market conditions. The Bank will use the funding for phase two to help finance the new subsidy policy. The Bank will consider approving phase two upon fulfillment of the performance indicators (section F of chapter II) agreed on between the Salvadoran government and the Bank.

The Bank's country and sector strategy:

The program will support the Bank's strategy in El Salvador through its intervention in the following areas: (a) development of the financial system; (b) strengthening of social policies to reduce poverty; (c) modernization of the public sector; and (d) strengthening environmental management at the local level.

The Salvadoran government drew up a reconstruction plan that was presented to Consultative Group in Madrid in mid-March 2001. The plan is to be implemented in three phases: (a) emergency, (b) rehabilitation, and (c) reconstruction in three principal areas: the social sectors (housing, education, and health), production, and infrastructure. The Bank has offered to provide financial and technical assistance for each phase and sector involved in the plan, coordinating its efforts with other international donors. The emergency loans (ES-0148 and ES-0150) supported the second stage of the reconstruction plan, with financing to mitigate risks, remove rubble, and build temporary housing. The recently approved loan for FISDL (ES-0120) and the present program are funding the third phase of the reconstruction plan, with supplementary financing for the sectors receiving support: the FISDL loan will finance reconstruction of all sectors covered in the reconstruction phase (education, health, infrastructure, and production) with the exception of permanent housing which will be supported under the present program (chapter I, section F).

Environmental and social review: The program will address environmental vulnerability issues, particularly in low-income settlements, through two main activities: certification of low-cost construction technologies capable of withstanding earthquakes, and the introduction of municipal environmental risk maps.

Studies conducted during program preparation reviewed the institutional and legal environmental framework in El Salvador, and concluded that the VMVDU and the municipal governments are the key institutions for ensuring compliance with environmental features. The lack of risk maps to guide urban planning was identified as a critical operational problem.

The Operating Regulations and profiles of the neighborhood upgrading, reconstruction, legalization, and certification programs include environmental criteria and procedures. The Committee on Environment and Social Impact will review the draft Operating Regulations (chapter III, section G).

Benefits: **Subprogram I** will strengthen the formal housing market by: (a) developing the mortgage market, which will help increase the commercial banks' capacity to originate mortgage loans and lower the cost of those loans to the buyer; and (b) ensuring the FSV's capacity to provide services to its target population, by improving its financial position and targeting its subsidies.

Subprogram II will strengthen the informal housing market by (a) implementing a sustainable subsidy program to address the problems of existing low-income neighborhoods, that will increase public investment in basic services infrastructure in the poorest neighborhoods; (b) expanding a program to promote investments in housing by families through legalization of land in irregular settlements; and (c) creating a program that responds to the problems faced by developers of new neighborhoods for low-income groups, to give buyers of lots the information that is needed for more informed decisions through a process of evaluating each developer's performance.

Subprogram III will produce benefits very similar to those described under Subprogram II, in low-income neighborhoods in the Municipality of San Salvador.

Response to natural disasters. The program will support the government's efforts to respond to natural disasters by: (a) allocating US$20 million to help finance a reconstruction program in areas damaged by the recent earthquakes; and (b) supporting efforts to minimize the impact of future natural disasters by developing local risk maps in municipalities that participate in the program. Municipal staff will be trained in using these maps to improve their capacity to evaluate permit applications for new urban developments.

Risks:

Subprogram I faces two main risks**:**

Financial failure. A failure to bring its costs under control, to improve the quality of its portfolio, and to implement new lending policies will erode the FSV's financial viability. To reduce this risk, a modernization plan has been developed with a selected set of indicators to monitor its financial progress. The process of designing the plan and agreeing on the indicators has been supervised by the FSV's senior management team and has their support. Moreover, the plan includes funding for dialogue, communications, and promotion to build a consensus amongst broad sectors of government and society on the FSV reforms introducing market interest rates and direct subsidies. Nonetheless, the ability of the FSV's senior management to provide leadership for this process of modernization will be critical to its success.

Political intervention. A series of recent events has demonstrated the FSV's vulnerability to political pressures that have contributed to its financial deterioration. Pressure from the construction industry and from monetary integration have contributed to this deterioration. The proposed changes to FSV's charter will strengthen its autonomy, but these measures have limitations. In the short and medium term, the FSV remains vulnerable to this risk.

Subprogram II faces one main risk:

Budgetary sustainability of the neighborhood upgrading subsidies. The main risk associated with a direct subsidy program is its budgetary sustainability. The program will support the government to shift its priorities in the area of housing policy and to use funding for the housing sector more efficiently, with ensuing savings for the housing policy budget. Furthermore, the design of the local counterpart will ensure that the amount of resources from the Government of El Salvador increases in each year of the program. Accordingly, the process for allocating substantial fiscal resources for these activities will be firmly established by the time the operation with the Bank is completed. Secondly, this component will place resources in the hands of municipalities where political parties other than that of the central government are in the majority. Multiparty support for these actions will help lower the risk of program termination.

Special contractual clauses:

1. Conditions precedent to the first disbursement for each component of the housing program

a. Submission of an execution agreement between the executing agency and the respective co-executing agency and an annual work plan for year one of the program. These agreements must contain at least the terms specified in paragraph 3.3. (paragraphs 3.4, 3.9, 3.11, 3.17, 3.24, 3.30, 3.38, and 3.42). Only the VMVDU modernization component and the component for progressive development of a subdivision market are exempted from this condition.

b. Submission of the corresponding Operating Regulations is an additional condition precedent for components offering direct subsidies (neighborhood upgrading subsidies, Municipality of San Salvador neighborhood reconstruction and upgrading subsidies) (paragraphs 3.5, 3.17, 3.24, 3.38).

2. Special execution conditions

a. After the first disbursement for the neighborhood upgrading subsidy component (Subprogram II), it must be demonstrated each disbursement request that the local counterpart funding required in accordance with table 2.1 is available (paragraph 2.19).

b. The borrower shall ensure that FONAVIPO does not undertake any new credit operations during program execution with the exception of contracts signed prior to 15 November 2001 until such time as an action plan has been agreed upon with the Bank for managing housing credit programs that satisfy at least the criteria indicated in paragraph 3.16. In each annual report, VMVDU will report to the Bank on the extent to which this condition has been fulfilled (paragraphs 3.16 and 3.58).

Poverty-targeting and social sector classification: This operation qualifies as a social equity-enhancing program, as described in the indicative targets mandated by the Bank's Eighth General Increase in Resources (document AB-1704).

Furthermore, this operation also qualifies as a poverty-targeted investment. The rationale for PTI classification is that more than 50% of the potential beneficiaries are below El Salvador's official poverty line (paragraph 4.18ff.).

Exceptions to Bank policy: None.

Procurement of goods and services: The standards and criteria of the Bank will apply to all contracting for goods and services. International competitive bidding procedures will be followed for construction contracts for amounts greater than US$1,000,000, and for procurement of goods and consulting services for amounts greater than US$200,000. Contracting for goods, construction, and consulting services for less than these amounts will be governed by national law provided that the law does not contravene the Bank's principles on this issue (paragraph 3.55).

Recognition of expenditures: Up to US$1,1 million in expenditures incurred since 31 March 2001 may be charged to the Bank financing, provided that procurement procedures substantially similar to those of the Bank have been followed. Of the total amount, expenses will be recognized as follows: up to US$100,000 incurred by FSV to hire consultants for the FSV institutional and financial strengthening component; up to US$400,000 in expenses incurred by VMVDU to hire consultants for the modernization of the Vice Ministry component; and up to US$600,000 in expenses incurred by Municipality of San Salvador to hire consultants for the Municipality of San Salvador institutional strengthening component and for investments in the Municipality of San Salvador neighborhood upgrading component (paragraph 3.56).